The Institute of Internal Auditors Australia

Factsheet: Internal Audit and Corporate Restructure or Collapse

This Factsheet applies to the internal audit role when a company is subject to merger, significant restructuring, or goes into administration. It is also relevant to Machinery of Government changes, which are treated as a merger and acquisition for the purposes of this Factsheet.

Definitions

- **Merger** – decision of two companies to reorganise their two separate organisations into a single company.
- **Corporate restructure** – action taken by a company to significantly modify financial and operational aspects, usually when the company faces financial pressure.
- **Corporate collapse** – insolvency or bankruptcy of a company.
- **Voluntary administration** – an administrator is appointed by the directors or a secured creditor to run a voluntary administration process. The aim is to help a company repay debts to escape insolvency if possible.
- **Involuntary administration** – occurs when it is creditors that decide to send a company into administration, and usually happens after a company has failed to repay its debts. The aim is to help a company repay debts to escape insolvency if possible.
- **Liquidation** – process of selling all assets before dissolving a company completely.
- **Machinery of government changes** – affect the public sector to achieve a similar effect to mergers and acquisitions by:
  - Creating a new government agency.
  - Creating a new portfolio or cluster.
  - Moving agencies between portfolios.
  - Closing an existing government agency.
  - Moving functions and responsibilities between government agencies.

Introduction

Boards may look to mergers and acquisitions when the growth of their company has stalled or when they are responding to disruptive innovation. The board might be looking for value creation or value enhancement by removing excess capacity, increasing market access, acquiring technology more quickly, developing new businesses, or improving the target company's performance.

Where companies might decide to merge with another company or restructure debt or operations as a means to improve profitability, the same applies to voluntary administration, though involuntary administration is generally forced upon a company by creditors. Reasons may vary, but are likely to be due to competition, declining market-share or costs exceeding profit. Sometimes it is outside a company's influence, such as international economic factors, natural disaster such as bushfires or cyclones, or as the world has seen recently it can be caused by disease pandemic.

In any of these events, the result is usually reduction in headcount and people losing their jobs. As a non-core function, internal audit can be at greater risk than other jobs.

A well-founded merger or acquisition can help to solidify the company's market position, eliminate competitors, fuel growth and expand operations. They can also help to quickly establish a brand in a growth market where the company being acquired is already in that market. The ultimate performance and finances of the merged entity will be shaped by elements overseen by the board, including the acquisition premium, bidding process and due diligence.

The most successful mergers and acquisitions are delivered and stand the test of time when the board's strategy and the chief executive officer's transition planning are strong and clear so that synergy benefits, economies of scale and cultural compatibility are achieved. Smooth transition is typically underpinned by proper communication, clear strategies and effective implementation. Development of a new vision for the merged organisation is imperative.

If the worst happens, what to do?

Depending on the circumstances, an IIA-Australia Factsheet 'Internal Auditor in Trouble' may provide some guidance, though this is more focused on an internal auditor being forced from an organisation where there is a major difference of opinion with management or an internal auditor faces a serious ethical issue.

Where an internal auditor's job may be threatened by cost saving following a merger, restructure or company going into administration, it is often left to the internal auditor to fight their own case for survival. The following are some tips and ideas about what could be considered.

Tip 1 – Be nimble

If the future is uncertain, internal audit will need to quickly get on the front foot to show where it can help and in a timely way. A slow and lumbering approach where elapsed time of internal audit delivery of services can take months is unlikely to cut it when time is of the essence to demonstrate where internal audit can quickly add value.

Tip 2 – Prepare a business case

One idea might be to show a 'plan on a page' showing how internal audit can help the business right now, which is likely to involve:

- A mix of internal audit advisory work to address 'here and now' issues.
- Business-as-usual high-risk activities.
- High-risks from the current situation which have heightened for example cyber security or fraud risk.
- Due diligence assistance.

Internal audit services would need to be short and sharp with immediate reporting and insightful value-adding results especially based around:

- High-risk mitigation.
- Efficiency improvement.
- Cost savings.
- Due diligence advice.

The board, audit committee and chief executive officer might find benefit in internal audit completing pre- and post-implementation type reviews to determine the precise extent of benefits realisation. The review should measure success of integration through three lenses – absolute performance, relative performance and realisation of synergies.

Tip 3 – Offer a wider range of services

Internal audit adopting a business-as-usual mindset and continuing to deliver the previously agreed internal audit plan may not be the best approach.

The idea would be to identify ways in which internal audit can move from a largely one-dimensional approach to the service it delivers, to an approach offering more dynamic and flexible services to match current needs of the company.

The IIA-Australia white paper 'Internal Audit Service Catalogue' describes ways in which Internal Audit could provide a range of services around corporate restructure or collapse which could include for example:

- Internal audit engagements
- Acquisition assurance
- Assurance advisory services
- Management requested services
- Business unit control advisory
- Health checks
- Multi-stage audits
- Project assurance
- Procurement advisory
- Preliminary reviews
- One-week reviews
- Risk and control improvement facilitation
- Control self-assessment
- Continuous auditing
- Forensic and fraud reviews
- Subsidiary assurance monitoring
- Special audits

Refer diagram below.

Tip 4 – Consider multi-stage audit

Another method used successfully by internal audit functions in some organisations provides agile real-time project assurance reporting, not after a project is completed and it is too late to influence whether it will be successful. This concept is Multi-Stage Audit (MSA).

As the name implies, MSA is an internal audit engagement conducted over a number of stages. MSAs aim to provide assurance and assist the effective planning, implementation and transition into business-as-usual activities of programs, projects and major business initiatives.

This can also be used to provide close to real-time assurance and advice to the board, audit committee and management about mergers, acquisitions and restructuring.

Each MSA stage review provides assurance and assists at critical points over the lifecycle of an implementation activity. This approach aims to provide assurance for informed management decision-making to proceed to the next stage and assure pre-requisites and planning have been effectively completed before launching the next stage.

This can be a valuable assurance tool, especially for auditing high-risk projects and major business initiatives which will be planned and implemented over a period of time.

The idea is that internal audit can provide assurance by adopting a lifecycle audit approach through agile 'short and sharp' assurance activities at key project stages. This provides immediate feedback as the implementation progresses and any areas requiring remedial action can be addressed at the time.

Refer IIA-Australia Fact Sheet 'Multi Stage Audits'.

Tip 5 – Pay your way

Some chief audit executives adopt an approach that their internal audit function will have a key performance measure (KPI) to pay for itself by savings generated from its audit observations. Many purists can be critical of this approach, but in the corporate world where internal audit is a non-core function and profit is king, it is something worth considering. It is usually popular with chief executive officers.

Where the company finds cash to be in short supply, this may be worthy of consideration by internal audit especially with a merger, acquisition and restructuring activity.

Tip 6 – Support the Audit Committee

A well-functioning and astute internal audit function can help the audit committee to carefully consider impacts of mergers and acquisitions progress (or machinery of government changes in the public sector) through regular reports on the merged organisation's overarching governance, risk management, control and compliance arrangements, and especially on the organisation's people.

The internal audit function can also provide an opinion on such things as:

› Employee turnover which is often a barrier to successful mergers and acquisitions.

› Organisation behaviour that should factor in the relative size, cultural differences and other variables of the respective organisations.

› Effectiveness of the communication strategy – all invested parties need to be informed of how the integration will proceed to alleviate fears, build trust and motivate the new combined team.

Tip 7 – Leverage stakeholder relationships

Chief audit executives who maintain active and effective stakeholder relationship management are often well-placed to understand the needs and expectations of their stakeholders especially during a period of change.

This is the time for the chief audit executive to ensure key stakeholders such as the board (or governing body), audit committee, chief executive officer, chief operating officer, chief finance officer, chief risk officer, etc champion continuing investment in an effective internal audit function.

Helpful references

'Internal Audit in Australia – second edition', IIA-Australia

Factsheet 'Agile Internal Audit', IIA-Australia

Factsheet 'Evolution of Internal Audit', IIA-Australia

Factsheet 'Internal Audit Consulting', IIA-Australia

Factsheet 'Internal Audit and Pandemics', IIA-Australia

Factsheet 'Internal Auditor in Trouble', IIA-Australia

Factsheet 'Multi Stage Audit', IIA-Australia

Factsheet 'Value-Based Internal Audit', IIA-Australia

White Paper 'Internal Audit Service Catalogue', IIA-Australia

White Paper 'Resourcing Internal Audit' IIA-Australia

White Paper 'Stakeholder Relationship Management', IIA-Australia

Example Internal Audit Service Catalogue							
Service offerings	**Service Type**	**Source**	**Elapsed timeframe**	**Persuasive Evidence***	**Opinion**	**Deliverable**	**Internal Audit monitor action plans**
Internal audit engagements	Assurance	Internal Audit	90 days	Yes	Yes	Report	Yes
Acquisition assurance	Assurance	Internal Audit / on request	60 days	Yes	Yes	Report	Yes
Assurance advisory services	Advisory	On request	Quick	Yes	No	Brief report	No
Management requested services	Assurance / Advisory	On request	Various	Yes	Yes / No	Report	Yes / No
Business unit control advisory	Advisory	On request	Quick	Yes	No	Brief report	No
Health checks	Assurance	Internal Audit / on request	Quick	Yes	Yes	Brief report	Yes
Multi-stage audits	Assurance	Internal Audit / on request	Life of activity	Yes	Yes	Reports at key timings	Yes
Project assurance	Assurance	Internal Audit / on request	Life of project	Yes	Yes	Reports at key project milestones	Yes
Procurement advisory	Advisory	On request	Quick	Yes	No	Summary	No
Preliminary reviews	Advisory	On request	Quick	Yes	No	Improvement roadmap	No
One-week reviews	Advisory	Internal Audit	Quick	Yes	No	Brief report	No
Risk and control improvement facilitation	Advisory	On request	Quick	Yes	No	Improvement roadmap	No
Control self-assessment	Advisory	On request	Quick	Yes	No	Brief report	No
Continuous auditing	Assurance	Internal Audit	Continuous	Yes	Yes	Ongoing reports	Yes
Forensic and fraud reviews	Assurance	Internal Audit / on request	60–90 days	Yes	Yes	Report	Yes
Subsidiary assurance monitoring	Assurance	Internal Audit	30 days	Yes	Yes	Report	Yes
Special audits	Assurance	Internal Audit / on request	60–90 days	Yes	Yes	Report	Yes

* Audit evidence is any information used by the auditor to determine whether the information being audited is stated in accordance with established criteria. Two determinants of persuasiveness of evidence are (1) Competence – the degree to which evidence can be considered trustworthy (2) Sufficiency – amount of evidence is enough to form a reasonable opinion.

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